

**STATE OF WASHINGTON  
OFFICE OF THE INSURANCE  
COMMISSIONER**



**FINANCIAL EXAMINATION  
OF  
FIRST CHOICE HEALTH PLAN, INC.  
SEATTLE, WASHINGTON**

**NAIC CODE 47046  
DECEMBER 31, 2003**

**EXHIBIT A**

**G05-81**

**First Choice Health Plan, Inc.**

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the First Choice Health Plan, Inc. of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2003.

Patrick H. McNaughton

Patrick H. McNaughton, Chief Examiner

October 17, 2005

Date

## TABLE OF CONTENTS

SCOPE OF EXAMINATION .....	1
INSTRUCTIONS.....	1
COMMENTS AND RECOMENDATIONS .....	5
COMPANY PROFILE .....	5
Company History.....	5
Capitalization .....	5
Territory and Plan of Operation .....	6
Growth of Company .....	6
AFFILIATED COMPANIES .....	6
Intercompany Contracts.....	6
MANAGEMENT AND CONTROL .....	7
Board of Directors.....	7
Officers.....	7
Conflict of Interest.....	7
Fidelity Bond and Other Insurance.....	7
Officers', Employees', and Agents' Welfare and Pension Plans .....	8
CORPORATE RECORDS .....	8
LOSS EXPERIENCE.....	8
REINSURANCE.....	9
STATUTORY DEPOSITS .....	9
ACCOUNTING RECORDS AND PROCEDURES .....	10
SUBSEQUENT EVENTS .....	10
FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS .....	10
FINANCIAL STATEMENTS .....	10
Assets, Liabilities, Capital and Surplus .....	11
Statement of Revenue and Expenses .....	12
Reconciliation of Surplus for the Period Since the Last Examination .....	13
Analysis of Changes in Financial Statements as a Result of the Examination .....	14
NOTES TO FINANCIAL STATEMENTS .....	15
ACKNOWLEDGEMENT .....	16
AFFIDAVIT.....	17

SALUTATION

Seattle, Washington  
October 17, 2005

The Honorable Mike Kreidler, Commissioner  
Washington State Office of the Insurance Commissioner (OIC)  
302-14<sup>th</sup> Avenue SW  
Olympia, WA 98504

Dear Commissioner :

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.44.145 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

FIRST CHOICE HEALTH PLAN, INC.  
of  
SEATTLE, WA

hereinafter referred to as "FCHP" or "the Company", at its home office located at 600 University Street, Suite 1400, Seattle, WA 98101. The following report on the examination is respectfully submitted showing the condition of the Company as of December 31, 2003.

## **SCOPE OF EXAMINATION**

This examination covers the period January 1, 1997 through December 31, 2003 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

## **INSTRUCTIONS**

The examiners reviewed the Company's filed 2003 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

### **1. Surcharges for Intercompany Services**

Since July 1, 1997, the Company has had an intercompany services agreement with a related company, First Choice Health Network (FCHN). Under the agreement, services rendered by FCHN are reimbursed at cost, plus surcharges for a 2 % Profit Margin and a 2 % Management Fee. However, under SSAP No. 70, paragraph (8), which became effective January 1, 2001, "shared expenses, including expenses under the terms of a management contract" must be charged on a cost basis. Since WAC 284-07-050(2) requires adherence to the appropriate Annual Statement Instructions and the SSAP, the amount of surcharges paid since 2001 can not be recorded as expenses.

Accordingly, the \$222,257 of surcharges paid to FCHN in 2003 and the \$669,513 paid in 2001 and 2002, should all have been recorded as capital contributions, in accordance with SSAP No 25, paragraph 16, rather than being treated as expenses. For 2003, this

recharacterization as a capital contribution will be made by examination adjustment No. 1, reducing both the 2003 general and administrative expenses, and the surplus account, by \$222,257. The \$669,513 of surcharges paid during 2001 and 2002 were similarly misclassified, but they have already have been charged to surplus as part of the annual transfer of the net loss to the capital accounts.

**In accordance with WAC 284-07-050(2), in the years 2001 through 2003, FCHP should have recorded surcharges of \$891,770 in conformity with statutory accounting practices. According to SSAP No. 70, paragraph (8), this requires recording such expenses on a cost basis. Since the cost basis was not used, SSAP No. 25, paragraph 16, mandates recording them as capital contributions to FCHN, rather than as general and administrative expenses. Examination adjustment number 1 corrects the 2003 distribution of \$222,257.**

## **2. Misclassified Claim Adjustment Expenses (CAE)**

A number of accounting classifications used in recording paid losses were not in compliance with the AP&P and the NAIC Annual Statement Instructions, including:

- a. A \$204,343 high risk pool assessment that was booked under medical claims. This should have been booked as general administrative expenses, per SSAP No. 35.
- b. The pharmacy benefit manager's administrative fees were recorded as prescription medical claims. Such fees should be shown as general administrative expenses.
- c. Network access fees were reported as medical claims. Pursuant SSAP No. 85, they are CAE and should not be included in the medical claims cost.
- d. FCHP included \$572,192 of unpaid claim adjustment expenses as part of the December 31, 2003 unpaid claims. According to the NAIC Annual Statement Instructions, the unpaid claim adjustment expenses should be separately shown and described as such in the NAIC Annual Statement.
- e. In accordance with SSAP No. 85, costs expected to be incurred in connection with the adjustment and recording of accident and health claims should be classified as CAE. These expenses must then be grouped into two categories: cost containment expenses and other claim adjustment expenses. The Company did not classify these expenses into cost containment expenses and other CAE.

**The Company is instructed to comply with RCW 48.43.097, RCW 48.44.095 and WAC 284-07-050(2) which require preparation and filing of financial statements in accordance with the AP&P and the NAIC Annual Statement Instructions. This requires the correct classification of all appropriate expenses as CAE and their further subclassification into cost containment and other claim adjustment expense categories.**

### **3. Investments: Annual Statement (Schedule D) Cost Data**

In the 2003 NAIC Annual Statement Schedule D - Part 1, the three columns entitled "Book/Adjusted Carrying Value, Fair Value and Actual Cost" all contained the same values for each security. In addition, the Company is adjusting actual cost for periodic repayments. According to the NAIC Annual Statement Instructions, actual costs include acquisition costs plus purchase expenses, and the carrying, fair and cost data should be unique for each issue.

**The Company is instructed to comply with RCW 48.43.097, RCW 48.44.095 and WAC 284-07-050(2), which require preparation and filing of financial statements in accordance with the AP&P and the NAIC Annual Statement Instructions. This includes using accurate data for completing all parts of the NAIC Annual Statement Schedules.**

### **4. Approval of Investments by Board of Directors**

Investment transactions were not approved by the Board of Directors (BOD) or an appropriate committee, as required by RCW 48.13.340, nor was the record of the investments required by RCW 48.13.350 maintained and signed by an officer.

**The Company is instructed to comply with RCW 48.13.340 which requires that "No investment, loan, sale or exchange thereof shall ... be made ... unless authorized or approved by its board of directors or by a committee charged ... with the duty of making such investment, loan, sale or exchange."**

**The Company is also instructed to follow RCW 48.13.350, which says that "As to each investment or loan of the funds of a domestic insurer a written record in permanent form showing the authorization thereof shall be made and signed by an officer of the insurer or by the chairman of such committee authorizing the investment or loan."**

### **5. Abandoned Property**

Over 100 checks written in 1998 and 1999 are still outstanding. The Washington State Uniform Unclaimed Property Act (RCW 63.29) requires that checks outstanding for more than 5 years be reported and paid to the state of Washington.

**The Company has outstanding checks which qualify as unclaimed property, and is instructed to report them, in compliance with RCW 63.29.170, and to pay them to the state of Washington, in compliance with RCW 63.29.190.**



## **6. Omissions in the Annual Statements**

The following disclosures required by the NAIC Annual Statement Instructions were missing from the 2003 NAIC Annual Statement Notes:

**Note 9** - Income Taxes: Current Income Tax Components and any Net Operating Loss carry forwards.

**Note 10** - Information Concerning Parent, Subsidiaries and Affiliates: Amount due to/from Parent and a description of material management or service contracts and cost-sharing arrangements.

**Note 12** - Retirement Plans: Parent/Holding Company Plans and Post-employment Benefits and Compensated Absences.

**Note 18** - Gain or Loss from Uninsured Plans: disclosure of ASO Plans.

**Note 22** - Reinsurance: Ceded Reinsurance and Commutation of Ceded Reinsurance.

**Note 27** - Health Care Receivable: Pharmacy Rebates Receivables and Risk Sharing Arrangements.

In the third quarter of 2004, the Company omitted all Notes to Financial Statements.

**The Company is instructed to comply with RCW 48.43.097, RCW 48.44.095 and WAC 284-07-050(2) which require preparation and filing of financial statements in accordance with the AP&P and the NAIC Annual Statement Instructions. This requires presenting all specified information in the Notes to Financial Statements.**

## **7. Intermediary Contract**

RCW 48.94.015 requires that transactions between the insurance company and its reinsurance broker can only be conducted under authorizations containing certain statutory provisions. The Company no longer has any reinsurance contracts in force but it could not produce an authorization for its prior broker.

**RCW 48.94.015 requires that a Company can only conduct business through a reinsurance broker under a written authorization satisfying certain statutory requirements. Since the reinsurance relationships no longer exist, and the Company has tendered its Certificate of Authority for cancellation, retroactive changes are not relevant or necessary.**

## **8. Claims Received but Unpaid**

Claims in process at year end are not recorded as such in the 2003 NAIC Annual Statement. Instead, they were included in the Incurred But Not Reported (IBNR) liability. This is not the correct presentation, since the NAIC Annual Statement Instructions and SSAP No. 55, paragraph 6.b, require that such claims must be shown as a separate liability.





The Company is instructed to separately present unpaid claims and IBNR, in compliance with RCW 48.43.097, RCW 48.44.095 and WAC 284-07-050(2) which require preparation and filing of financial statements in accordance with the AP&P and the NAIC Annual Statement Instructions.

#### **9. Uncovered Expenses and Claims Adjustment Expense Allocation**

Claims from outside the covered area (Uncovered Expenses) were calculated as a percentage of the total claims in each category. The Company could not provide supporting documentation for the allocation percentage. In addition, documentation was not provided to justify either the allocation of expenses to the claims adjustment expenses category or the allocation of FCHN expenses to FCHP. All of these inadequacies were at variance with the provisions of SSAP No. 70, paragraphs 1 through 11.

SSAP No. 70 describes certain criteria for expense allocation and RCW 48.44.100 forbids the Company to knowingly file or disseminate any inaccurate financial statements. The Company is instructed to follow the provisions of SSAP No. 70 and to adequately document such allocations, so as to comply with RCW 48.44.100 and with WAC 284-07-050, which requires following the SSAP .

### **COMMENTS AND RECOMMENDATIONS**

NONE

### **COMPANY PROFILE**

#### **Company History**

FCHP was incorporated on December 21, 1994, and was admitted to Washington State as a Health Care Service Contractor (HCSC) on January 13, 1995 the Company began writing prepaid group health care plans in 1996. In July 1997, the Company absorbed two similar health plan companies, Sound Health and Health First Partners.

FCHP has had several consecutive years of operating losses, so the BOD authorized an orderly withdrawal from the insured health care business by December 31, 2003. Subsequently, the Company has no plans for further activities; it tendered its Certificate of Authority to do business in Washington and filed Articles of Dissolution with the Secretary of Washington State.

#### **Capitalization**

As of December 31, 2003, there were 226,518 shares of \$10 par value common stock and 120,079 shares of \$29.10 par value preferred stock outstanding. There was also



\$28,584,500 of contributed capital, bringing the total invested capital to \$34,343,979. This was partially offset by an unassigned surplus deficit of \$25,858,108, bringing the net capitalization to \$8,485,871.

### **Territory and Plan of Operation**

In early 2003, FCHP ceased renewing any of its commercial insurance contracts and completed its withdrawal from the insurance market on December 31, 2003. Before its withdrawal, the Company was doing business in the following Washington State counties: King, Lewis, Mason, Pierce, Snohomish, Thurston, Adams, Lincoln, Spokane, Stevens, and Whitman.

### **Growth of Company**

The Company's five year growth, as reported in its filed NAIC Annual Statements, is illustrated below as of December 31:

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Total admitted assets	\$12,309,657	\$16,185,835	\$21,428,005	\$20,633,312	\$19,701,884
Total liabilities	3,823,786	10,320,905	15,673,925	15,278,104	13,226,620
Total capital and surplus	8,485,871	5,864,930	5,754,080	5,355,208	6,475,264
Total revenue	16,367,257	41,370,619	65,602,287	124,277,135	78,039,511
Total hospital and medical	10,774,182	37,018,950	58,468,637	117,634,910	69,688,233
Total administrative expenses	4,282,821	8,842,225	11,861,455	12,596,231	10,995,648
Net underwriting gain	391,435	(6,402,483)	(7,408,610)	(8,731,649)	(3,130,822)
Net investment gain	283,806	526,416	807,220	685,301	405,926
Total other income	2,723,726	2,815,794	2,741,946	2,789,055	2,208,299
Net income or (loss)	\$2,365,809	(\$1,452,534)	(\$2,949,651)	(\$5,257,293)	(\$516,598)

### **AFFILIATED COMPANIES**

First Choice Health Plan is 80% owned by FCHN, which is owned by 11 hospitals and 538 physicians. The other 20% is owned by Washington Health Care Alliance, LLC, MultiCare Health System, and Swedish Health Services.

FCHN is a Preferred Provider Organization which contracts with hospitals, physicians and ancillary services in the State of Washington.

### **Intercompany Contracts**

The Company has the following intercompany agreements:

Management Services Agreement	Dated July 1, 1997.
Contribution Agreement	Dated July 1, 1997
Tax Sharing Agreement	Dated July 1, 1997

## MANAGEMENT AND CONTROL

### **Board of Directors**

<u>Name</u>	<u>Principal Business Affiliation</u>
Greg Van Pelt	Vice President and Chief Executive Officer – Providence Health System
Paul M. Elliott	Retired
Kenneth D. Graham	President & CEO – Overlake Hospital Medical Center
Phillip J. Haas	Administrator for Payer and Government Relations – Valley Medical Center
William F. Johnston, M. D.	Medical Director of Emergency Services – Northwest Hospital
Garman E. Lutz	President & CEO – Empire Health Services
Barbara L. Mitchell	Administrator of Organizational Development for Valley Medical Center
Richard A. McGee, M. D.	Physician and President of Puget Sound Cancer Centers
Richard H. Peterson	President & CEO – Swedish Health Services
Paul G. Ramsey, M. D.	Dean of the School of Medicine – University of Washington
Richard E. Rust, M. D.	Retired Family Practitioner
Clyde D. Walker, M. D.	Physician
Diane E. Cecchettini, R. N.	President and Chief Exec Officer – MultiCare Health Systems
Gerald A. Cufley, M. D.	Physician
Scott F. Kronland, M. D.	Vice President, Good Samaritan Community Healthcare
Mitchell B. Weinberg, M. D.	Physician

### **Officers**

<u>Name</u>	<u>Title</u>
Gary R. Gannaway	President & Chief Executive Officer
Kenneth A. Hamm	Executive Vice President – Chief Financial Officer
Ross D. Heyl	Vice President – Chief Marketing Officer
Ze'ev Young, M. D.	Vice President – Chief Medical Officer

### **Conflict of Interest**

All officers, directors, and key employees are required to sign an annual Conflict of Interest Statement. (See Instruction No. 10)

### **Fidelity Bond and Other Insurance**

The Company is a named insured on a crime insurance policy purchased by its parent, covering employee and computer theft, forgery and fraud, with a \$15,000 per claim deductible. The coverage limit is \$1,000,000, which exceeds the minimum amount recommended by the NAIC.

FCHP is also a named insured on property and liability insurance obtained by the parent. On December 31, 2003, the policies provided coverage for real and personal property, commercial general liability, umbrella/excess liability, financial institution fidelity bond, fiduciary liability, directors' and officers' liability, errors and omissions liability and managed care organization liability.

### **Officers', Employees', and Agents' Welfare and Pension Plans**

FCHP does not have employees. All FCHP workers are employees of FCHN.

### **CORPORATE RECORDS**

The Articles of Incorporation did not change since the previous examination date. The Corporate Bylaws were amended effective June 22, 2000.

FCHP filed Articles of Dissolution with the Secretary of State and the Insurance Commissioner's Office, and ceased doing business effective January 1, 2004.

The annual meeting of the shareholders is on or before June 30<sup>th</sup> of every year. A special meeting of the shareholders may be called at anytime by holders of 20% of the voting stock of the Company, the BOD, the Chairman of the BOD, or the President.

### **LOSS EXPERIENCE**

The OIC actuary reviewed the FCHP claims unpaid for the year ending December 31, 2003. This review included examining the Company's reserving philosophy and methodologies to determine the reasonableness of the liabilities booked on Page 3, Line 1 through Line 7 of the Company's 2003 NAIC Annual Statement, verifying that claim liabilities include provisions for all components noted in SSAP No. 55, paragraphs 7 and 8, checking the consistency of the incurred-paid data from the Company's system with the figures reported in its 2003 NAIC Annual Statement, and estimating claims unpaid for the valuation date of December 31, 2003. The following is a summary of that review.

FCHP is licensed as a Health Care Service Contractor and is in voluntary dissolution, without regulatory oversight, effective January 1, 2004. According to FCHP, no business was renewed after January 2003 and its operations are in the process of being eliminated. FCHP liabilities are recorded and paid through December 31, 2004.

The Company issued commercial comprehensive and Medicare supplement plans. In the 2003 NAIC Annual Statement, FCHP booked a total of \$3,069,224 in unpaid claims. The following details were provided by FCHP:

Commercial Comprehensive Plans	\$1,207,590
Explicit Margin	1,100,000
Unpaid Claims Adjustment Expenses	572,192
Pharmacy	59,442
Medicare Supplement	<u>130,000</u>
Total	<u>\$3,069,224</u>

The Company's actuary estimated the unpaid claims for commercial comprehensive plans and pharmacy plans as \$1,144,807 and \$94,389, respectively. The actuary's 2003 reserving model and the methodologies used to develop unpaid claims were reviewed. The reserving model is reasonable, and is one of the methods prescribed by the American Academy of Actuaries. As shown above, some numbers used by FCHP are different from those of the actuary, but no examination adjustment will be made due to immateriality. The OIC actuary's estimates of unpaid claims were lower than those of the Company's actuary.

FCHP included the \$572,192 unpaid claim adjustment expenses in the unpaid claims. This is a misclassification. According to the NAIC Annual Statement Instructions, the unpaid claim adjustment expenses should be booked separately in Page 3, Line 3 of the 2003 NAIC Annual Statement. (See Instruction No. 2)

### REINSURANCE

Through December 31, 2003, the Company was reinsured for contractually covered hospital and medical expenses paid within twelve months after the calendar year of occurrence. The coverage was limited to a calendar year maximum per member of \$247,500 in excess of \$2,500. FCHP was further reinsured for the annual excess of such expenses over \$500,000, to a lifetime maximum of \$2,000,000 per member. Both of these covers were issued by an adequately-rated company and contained an insolvency clause or a condition that the contract was governed by the laws of Washington State. Both contracts are now terminated.

### STATUTORY DEPOSITS

The Company has the following statutory deposit:

<u>State</u>	<u>Par Value</u>	<u>Market Value</u>	<u>Statement Value</u>
Washington	\$384,224	\$384,224	\$384,224

## **ACCOUNTING RECORDS AND PROCEDURES**

The Company maintains its accounting records on a GAAP accrual basis of accounting and adjusts to a Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is annually audited by a CPA firm and received an unqualified opinion for all years under review.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written disaster recovery plan.

## **SUBSEQUENT EVENTS**

In 2003, FCHP ceased renewing insurance contracts and had completely withdrawn from the market by December 31, 2003. Subsequently, the Company tendered its Certificate of Authority for Washington and made an application for voluntary dissolution to the Washington Secretary of State. Its funds are being returned to the owners and there is no plan for any future activities. (See Instruction No. 1)

## **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

All previous report instructions and comments were subsequently corrected.

## **FINANCIAL STATEMENTS**

Assets, Liabilities, Capital and Surplus  
Statement of Revenue and Expenses  
Reconciliation of Surplus for the Period since the Last Examination  
Analysis of Changes in Financial Statements as a Result of the  
Examination

**FIRST CHOICE HEALTH PLAN, INC.**  
**ASSETS, LIABILITIES, CAPITAL AND SURPLUS**  
**DECEMBER 31, 2003**

	<u>BALANCE PER</u> <u>COMPANY</u>	<u>REF</u>	<u>EXAM</u> <u>ADJ</u>	<u>BALANCE PER</u> <u>EXAM</u>
<u>ASSETS</u>				
Bonds	\$8,041,272			\$8,041,272
Cash and short term investments	3,071,875			3,071,875
Subtotal, cash and invested assets	11,113,147			11,113,147
Uncollected premiums	898,489			898,489
Other Receivables	244,978			244,978
Receivable from parent, subsidiaries and affiliates	0			-
Healthcare and other amounts receivable	15,641			15,641
Investment income due and accrued	37,402			37,402
TOTAL ASSETS	\$12,309,657		\$0	\$12,309,657
<u>LIABILITIES</u>				
Claims unpaid	\$3,069,224			\$3,069,224
Accrued medical incentive pool and bonus amounts	83,787			83,787
General expenses due or accrued	595,349			595,349
Premiums received in advance	17,099			17,099
Payable to parent, subsidiaries and affiliates	58,327			58,327
TOTAL LIABILITIES	3,823,786		0	3,823,786
<u>CAPITAL AND SURPLUS</u>				
Common capital stock	2,265,180			2,265,180
Preferred stock	3,494,299			3,494,299
Gross paid in and contributed capital	28,584,500			28,584,500
Unassigned funds	(25,858,108)			(25,858,108)
Capital and surplus	8,485,871		0	8,485,871
TOTAL LIABILITIES, SURPLUS AND OTHER FUNDS	\$12,309,657		\$0	\$12,309,657

**FIRST CHOICE HEALTH PLAN, INC.**  
**STATEMENT OF REVENUE AND EXPENSES**  
**DECEMBER 31, 2003**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAMINATION
<b>INCOME</b>				
Net premium income	\$15,621,156			\$15,621,156
Change in unearned premium reserves	746,101			746,101
Total revenue	<u>16,367,257</u>			<u>16,367,257</u>
<b>HOSPITAL AND MEDICAL</b>				
Hospital /medical benefits	16,826,218			16,826,218
Other professional services	1,403,107			1,403,107
Emergency room and out of area	1,006,603			1,006,603
Prescription drugs	4,666,937			4,666,937
Incentive pool, withhold adjustments & bonus amounts	144,925			144,925
Net reinsurance recoveries	(13,273,608)			(13,273,608)
Total Hospital and Medical	<u>10,774,182</u>			<u>10,774,182</u>
Claim adjustment expenses	918,819			918,819
General administrative expenses	4,282,821	1	(222,257.00)	4,060,564
Total underwriting deductions	<u>15,975,822</u>			<u>15,753,565</u>
Net underwriting gain or (loss)	391,435			613,692
Net investment income	283,806			283,806
Network Access Fees	<u>2,723,726</u>			<u>2,723,726</u>
Net income before federal income taxes	3,398,967			3,621,224
Federal and foreign income taxes incurred	<u>1,033,158</u>			<u>1,033,158</u>
Net income	<u><u>\$2,365,809</u></u>			<u><u>\$2,588,066</u></u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>				
Capital and Surplus, December 31, 2002	<u>\$5,864,930</u>			<u>\$5,864,930</u>
Net Income	2,365,809			2,588,066
Change in net deferred income tax	(122,489)			(122,489)
Change in non-admitted assets and related items	164,612			164,612
Paid in (surplus adjustments)	213,009	1	(222,257.00)	(9,248)
Net change in capital and surplus for the year	<u>2,620,941</u>			<u>2,620,941</u>
Capital and Surplus, December 31, 2003	<u><u>\$8,485,871</u></u>			<u><u>\$8,485,871</u></u>

**FIRST CHOICE HEALTH PLAN, INC.**  
**5 YEAR RECONCILIATION OF SURPLUS**  
**FOR THE PERIOD SINCE THE LAST EXAM**

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Capital and Surplus, December 31,	\$5,864,930	\$5,754,081	\$5,355,209	\$6,475,246	\$7,121,270
Net income	2,588,066	(1,452,535)	(2,949,648)	(3,417,113)	(155,271)
Change in net unrealized capital gains		36,358	(8,501)		
Change in unrealized foreign exchange					
Change in net deferred income tax	(122,489)	(576,607)	243,805		
Change in reserve on acct of change in					
Change in non-admitted assets and related	164,612	185,633	(34,162)	(1,917,459)	(490,753)
Change in asset valuation reserve					
Amount of Currency Translation					
Cumulative effect of changes in accounting			2,372,378		
Decrease in subscription receivable				1,714,515	
Paid in(surplus adjustments)	(9,248)	1,918,000	719,560	2,444,580	
Paid in (capital changes)			55,440	55,440	
Net change in capital and surplus for the	<u>2,620,941</u>	<u>110,849</u>	<u>398,872</u>	<u>(1,120,037)</u>	<u>(646,024)</u>
Capital and surplus on December 31, 2003	<u>\$8,485,871</u>	<u>\$5,864,930</u>	<u>\$5,754,081</u>	<u>\$5,355,209</u>	<u>\$6,475,246</u>

**FIRST CHOICE HEALTH PLAN, INC.**  
**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS AS A RESULT OF THE EXAMINATION**  
**DECEMBER 31, 2003**

	<u>PER COMPANY</u>	<u>PER EXAMINATION</u>	<u>EXAMINATION ADJUSTMENT REFERENCE</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>	<u>TOTAL</u>
Capital and Surplus, 12/31/2003 Per NAIC Annual Statement					\$8,485,871
<b><u>STATEMENT OF REVENUE AND EXPENSES</u></b>					
General administrative expenss	4,282,821	4,060,564	1	(222,257)	(222,257)
<b><u>CAPITAL AND SURPLUS ACCOUNT</u></b>					
Paid in (surplus adjustments)	213,009	(9,248)	1	222,257	222,257
Capital and Surplus, 12/31/2003 Per Examination					<u><u>\$8,485,871</u></u>

## **NOTES TO FINANCIAL STATEMENTS**

1. The Company's intercompany services agreement with FCHN contained a 4% markup for management fees and profit. Since such markups are contrary to SSAP No. 70, paragraph 8, they should be recharacterized as capital distributions under SSAP No. 25 paragraph 16. Therefore, the 2003 markup of \$222,257 is being reversed from general and administrative expenses and charged to surplus by examination adjustment number 1.

2. The Company has no special consents, permitted practices or orders from the state of Washington.

### ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

In addition to the undersigned, John Gaynard, CFE, CPCU, FLMI, CPA; Kathy Hicks, CPA; Michael V. Jordan, CFE, CPA, MHP; John Jacobson, AFE, AES, and Lichiou Lee, ASA, MAAA, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

*Constantine Arustamian*

Constantine Arustamian, CFE, CPA

Examiner-in-Charge

Washington State Office of the Insurance Commissioner

**AFFIDAVIT**

State of Washington            )  
  ) ss  
County of King                 )

Constantine Arustamian, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

*Constantine Arustamian*

Constantine Arustamian, CFE, CPA  
State of Washington

Subscribed and sworn to before me on this 17<sup>th</sup> day of October, 2005.

*Colleen Jansen*  
Notary Public in and for the  
State of Washington

